BACK TO BUSINESS

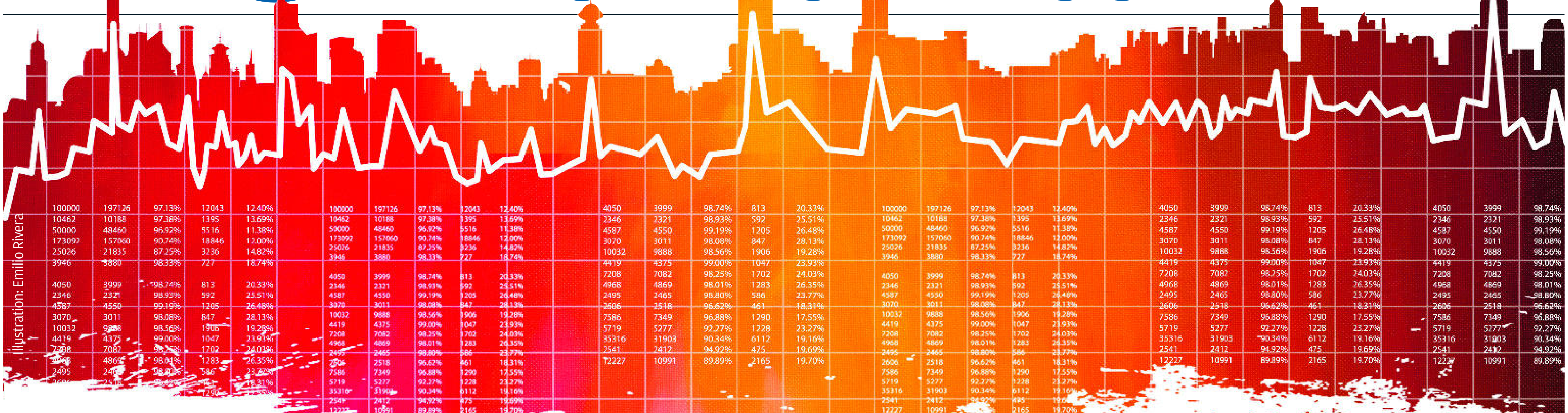
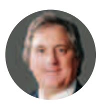


Illustration: Emilio Rivera



THE VIEW
RICHARD HARRIS

Markets get connected

Launch of cross-border stock trading scheme could herald major changes in global capital markets

Forget about "One Country, Two Systems". We have moved onto One Country, Two Jurisdictions.

The haste with which the Shanghai-Hong Kong Stock Connect scheme was announced, less than five trading days before kick off, gives credence to the view that the continuing presence of the revolting students in the pedestrian precinct formerly known as Harcourt Road caused the three-week delay to the original timetable.

But scheme is a lot more important than Hong Kong's little local difficulties. The Xi-Li administration in Beijing may have set out their stall as political conservatives, but at the same time they seem to be economic liberals. Stock Connect is an important pillar in the reform of mainland capital markets.

It is inconceivable that such a reform could have been negotiated quickly, incorporating as it does the agreement of two stock exchanges in very different jurisdictions, many and various compliance regulators, governments at various levels, different taxation authorities, and the bridging of broker trading, settlement and custody processes.

HKEx chief Charles Li Xiaojia and chairman Chow Chung-kong are keen to see Stock Connect trading after a delay. Photo: Sam Tsang

For two very different jurisdictions to comprehensively join hands could also herald broader change in global capital markets.

> **Stock Connect will be of much more use to the mainland than to Hong Kong**

There are several global companies with dual listings, such as HSBC in London and Hong Kong, and Royal Dutch Shell in London and Amsterdam, but 500-odd stocks being traded in such a manner could signify the beginning of the end for the traditional national stock exchange.

It has long been my view that we are progressing towards a world in which a few global exchanges trade shares of global titan firms around the clock. National stock exchanges will be left to trade smaller national stocks. The Shanghai-Hong Kong Stock Connect may well lead the way.

The details of the scheme have been hammered out in private and no doubt many devils are likely to be uncovered when trading begins on Monday.

Much cynicism abounds for a proposal that has taken nearly a decade to see the light of day. How much will either side want to claw back if the practice does not prove as successful as the theory? Could it be a Money-Launderer's Charter, whereby corrupt money is washed clean through cross-border transactions?

Is it overwhelmingly political? The timing of the announcement can be seen to underpin the ragged reputation of Chief Executive Leung Chun-ying, but Stock Connect is more about economic liberalisation than political posturing.

The authorities have not been generous in releasing details to the investing public, perhaps for fear of upsetting the negotiations. Market talk is that mainlanders will be able to buy large and mid-cap Hong Kong stocks. On the mainland, 266 stocks are likely to be open for foreigners to buy, although another theory goes that as many as 570 companies may be open to the new investor base.

Trade from Shanghai to Hong Kong is limited to 250 billion yuan (HK$315.43 billion) in total, some 1.8 per cent of the combined capitalisation of the Hang Seng and the H-share Index. Each day, mainland investors will be able to buy up to 10.5 billion yuan of stock, about 26 per cent of recent daily turnover.

Funds going into Shanghai are limited to 300 billion yuan daily, or 1.7 per cent of the Shanghai A-share capitalisation. Foreign investors will be limited to 13 billion yuan daily – just over 5 per cent of daily turnover, much less than Hong Kong.

It seems Beijing did not want foreigners buying too much of the market or bringing in volatile hot money. The overall limits are modest, but investable. We all know, however, that prices are set on the margin and the new investors might just have enough conviction to set the regular investor base trading madly, if the conditions are right. It is volatility that makes markets so interesting for investors.

¥13b
Foreign investors' daily quota for buying Shanghai shares through Stock Connect, in yuan

Overall, Stock Connect will be of much more use to the mainland than to Hong Kong. It is a tool to develop effective capital markets to fund its most competitive companies and take pressure off the banking system to provide short-term loans. Foreign investors in A shares will bring in new valuation techniques that will no doubt find and reward good quality companies.

Just one trading day to go and we will embark on a new journey that will accelerate mainland economic reform. After Monday, everyone will be committed to its success. Next up is the investment fund industry, which is actively discussing its own version of Stock Connect to open funds to investors on both sides of the Lo Wu checkpoint.

Richard Harris is chief executive of Port Shelter Investment Management